

Message Text

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ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 EURE-00 SP-02 USIA-06 AID-05

EB-07 NSC-05 CIEP-01 TRSE-00 SS-15 STR-04 OMB-01

CEA-01 CIAE-00 COME-00 FRB-03 INR-07 NSAE-00 XMB-02

OPIC-03 LAB-04 SIL-01 L-03 H-02 PA-01 PRS-01 /094 W

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FM AMEMBASSY ROME

TO SECSTATE WASHDC PRIORITY 6410

INFO AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

USMISSION EC BRUSSELS

AMEMBASSY THE HAGUE

AMEMBASSY LONDON

AMEMBASSY OTTAWA

AMEMBASSY PARIS

USMISSION OECD PARIS

AMEMBASSY STOCKHOLM

AMEMBASSY TOKYO

C O N F I D E N T I A L ROME 4362

PASS TREASURY AND FRB

E.O. 11652: GDS

TAGS: EFIN, IT

SUBJECT: GOI CREDIT NEGOTIATIONS WITH EC AND IMF

REF: EC BRUSSELS 2319

1. SUMMARY. EC MINISTERS OF FINANCE APPROVED \$1 BILLION
LOAN TO ITALY ON MARCH 15 CONDITIONAL UPON ECONOMIC POLICY
MEASURES DESIGNED TO LIMIT DOMESTIC CREDIT EXPANSION
(EXPECIALLY CREDIT TO FINANCE CASH BUDGET DEFICIT),
CONTROL INCREASE IN BUDGET EXPENDITURES, REDUCE TAX
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EVASION AND CONTAIN EXPANSION OF WAGES AND SALARIES.
IN MEANTIME IMF MISSION IS STILL IN ROME NEGOTIATING

WITH GOI ON STANDBY AGREEMENT FOR ABOUT \$530 MILLION. MIN TREAS OFFICIAL SAYS THAT IT IS TOO EARLY TO JUDGE WHETHER IMF TALKS ARE GOING WELL OR NOT. IMF MISSION IS EVIDENTLY EXAMINING ITALIAN SITUATION IN GREATER DEPTH THAN EC DID. END SUMMARY.

2. TREASATT SAW DIRECTOR GENERAL PALUMBO OF TREASURY ON MARCH 16 TO ASK ABOUT RESULTS OF MARCH 15 EC MINFIN MEETING AND ABOUT PROGRESS ON IMF STANDBY NEGOTIATIONS. PALUMBO SAID THAT EC MINISTERS HAD APPROVED COMMISSION'S PROPOSED POLICY CONDITIONS WITH LITTLE DEBATE. CHIEF CONDITIONS (SEE REFTEL) ARE: (A) LIMIT ON DOMESTIC CREDIT EXPANSION OF 29,500 MILLION LIRE, (B) LIMIT ON FINANCING OF CASH BUDGET DEFICIT OF 13,800 BILLION LIRE, (C) SUB-CEILING ON CENTRAL BANK FINANCING OF BUDGET DEFICIT OF 5,700 BILLION LIRE, (D) LIMIT ON BUDGET EXPENDITURES OF 39,700 BILLION LIRE, (D) CEILING ON RATE OF INCREASE IN BUDGET EXPENDITURES EQUAL TO INCREASE IN GDP IN CURRENT LIRE, (F) CONTAINMENT-OF DEFICITS OF LOCAL GOVERNMENTS, (G) INTENSIFICATION OF CAMPAIGN TO RESTRICT EXPANSION OF MONEY INCOMES WITHIN LIMITS COMPATIBLE WITH DOMESTIC FINANCIAL AND BALANCE OF PAYMENTS EQUILIBRIA.

3. MECHANISM FOR JOINT BORROWING AND APPROXIMATE TERMS OF LOAN ARE AS FOLLOWS: (A) \$300 MILLION SIX-YEAR EUROBOND ISSUE AT 8.9 PERCENT, (B) DM 500 MILLION SEVEN-YEAR EUROBOND ISSUE (ABOUT \$200 MILLION) AT 7.7 PERCENT, (C) \$300 MILLION FIVE-YEAR EUROLOAN WITH VARIABLE INTEREST RATE BASED ON LONDON INTERBANK RATE PLUS SPREAD OF 1 PERCENT AND 0.25 PERCENT BANK COMMISSION, (D) AND REMAINDER OF ABOUT \$500 MILLION ISSUE OF EURONOTES FOR UP TO FOUR YEARS AT 7.5 PERCENT. AVERAGE INTEREST COST ON BORROWING WOULD BE 8-8 1/4 PERCENT, AND AVERAGE MATURITY WOULD BE ABOUT FIVE YEARS. TOTAL BORROWING WOULD BE \$1.3 BILLION, OF WHICH \$1.0 BILLION WOULD BE RE-LENT TO ITALY AND \$0.3 BILLION WOULD BE RE-LENT TO IRELAND. EACH OF FOUR SEGMENTS OF EUROMARKET BORROWINGS WOULD BE RE-LENT PROPORTIONATELY BETWEEN ITALY AND IRELAND.
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4. DR. PALUMBO SAID THAT IMF MISSION HAD ARRIVED IN ROME MARCH 10 AND WOULD PROBABLY STAY THROUGH WEEK OF MARCH 19. IMF MISSION WAS EXAMINING ITALIAN ECONOMIC SITUATION IN GREATER DEPTH THAN MISSION FROM EC HAD DONE. (PALUMBO ADMITTED THAT CONDITIONS ATTACHED TO EC LOAN REFLECTED POLITICAL AS WELL AS ECONOMIC CONSIDERATIONS.) FUND MISSION WAS PAYING PARTICULAR ATTENTION TO COMPOSITION OF CASH BUDGET DEFICIT, ESPECIALLY DEFICITS OF AUTONOMOUS ENTITIES, E.G., POST AND TELECOMMUNICATIONS AND STATE

RAILROADS. PALUMBO SAID THAT IT WAS TOO EARLY TO EVALUATE WHETHER NEGOTIATIONS WERE GOING WELL OR BADLY. AS TO RELEASE OF EVENTUAL STANBY CREDIT, PERHAPS THIS WOULD BE IN THREE TRANCHES, WHICH MIGHT BE FRONT-END LOADED.

5. COMMENT. GOI APPARENTLY BELIEVES THAT IT CAN LIVE WITH CONDITIONS ATTACHED TO EC LOAN, EVEN THOUGH THEY ARE MORE STRINGENT THAN THOSE AGREED TO IN CONNECTION WITH OLD MEDIUM-TERM CREDIT LATE LAST YEAR. APART FROM REDUCTION IN SPECIFIC FIGURES, WORSENING INFLATIONARY SITUATION DUE, IN PART, TO LIRA DEPRECIATION MAY MAKE CEILINGS RELATIVELY MORE RESTRICTIVE THAN SMALL CHANGE IN ABSOLUTE NUMBERS SUGGESTS. POLITICAL AND COMMERCIAL POLICY MOTIVATIONS OBVIOUSLY ARE FACTOR BEHIND WILLINGNESS OF ITALY'S EC PARTNERS TO GUARANTEE EC JOINT BORROWING IN FAVOR OF ITALY. SPECIFICALLY, THERE IS CLEAR CONCERN WITHIN COMMUNITY ABOUT DOMESTIC POLITICAL SITUATION IN ITALY, PLUS WISH TO PROTECT OTHER MEMBER COUNTRIES' EXPORT INTERESTS IN FACE OF IMPROVEMENT IN ITALY'S COMPETITIVE POSITION THROUGH SHARP DROP IN LIRA EXCHANGE RATE. WHILE EC MISSION HAD TO TAKE THESE FACTORS INTO ACCOUNT IN FORMULATING CREDIT CONDITIONS, DESPITE GENERAL FAILURE OF ITALY TO MEET MEDIUM-TERM CREDIT CONDITIONS IN 1975, IMF MISSION IS NOT SO ENCUMBERED WITH POLITICAL/COMMERCIAL CONSIDERATIONS AND IS EVIDENTLY PUSHING HARDER ON FISCAL POLICY AND, PERHAPS, INCOMES POLICY QUESTIONS THAN EC DID. VOLPE

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